Tomorrow's Affairs

Analysis of today
Assessment of tomorrow

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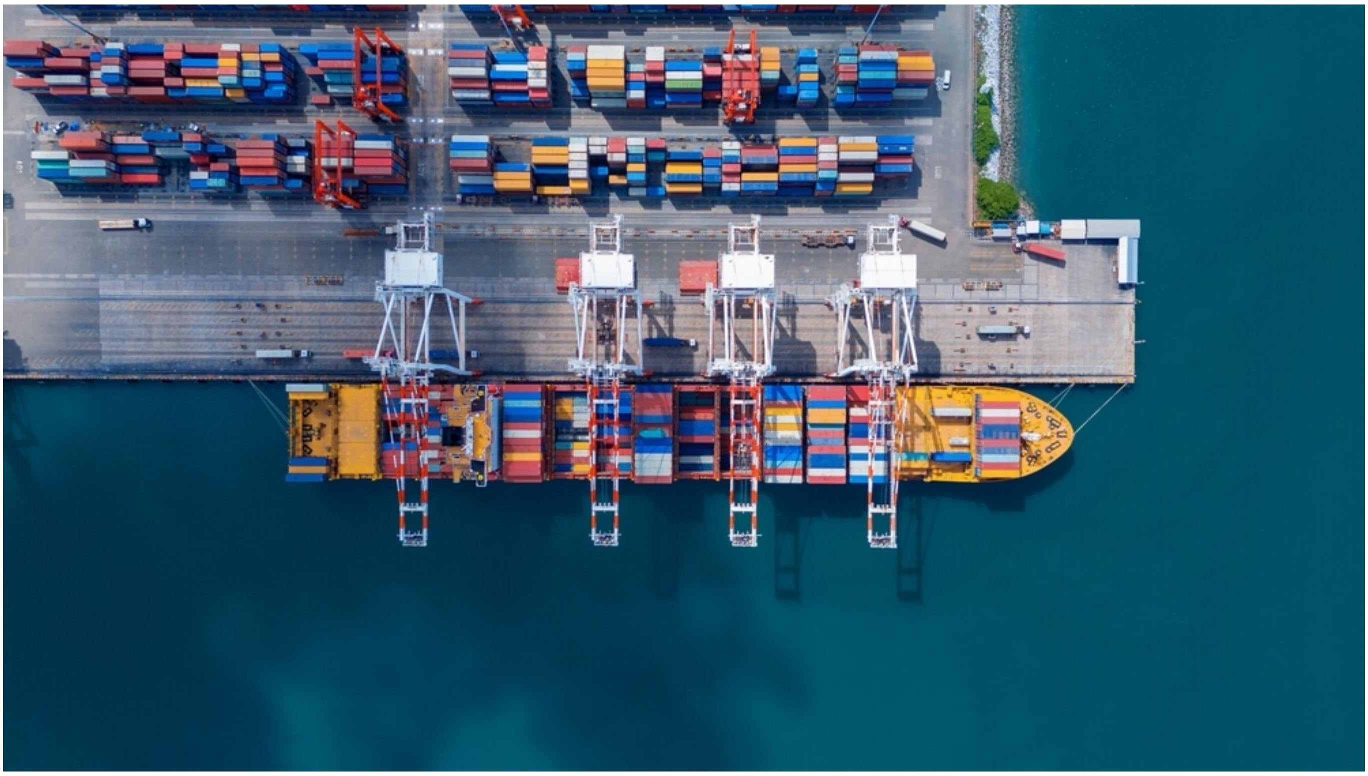
The buffers that have shielded the global economy are depleting



For decades, companies, investors, and policymakers operated on the comforting assumption that the global economy was underpinned by a relatively stable equilibrium.

Macroeconomic and financial shocks were treated primarily as cyclical disruptions that could be managed to put things back on track toward a predictable destination—that of per capita GDP growth within a continuously globalizing economic and financial order.

But this paradigm is now being challenged by geopolitical tensions, the weaponization of economic relations, the rapid advance of new technologies, and other factors.

Navigating economies and markets through this storm is possible, but it requires a commitment to building resilience, maintaining optionality, and demonstrating agility.

That will not happen automatically, because there is now uncertainty about the theoretical and practical endpoints of many ongoing secular changes—from productivity and economic growth to supply chains and equilibrium interest rates.

Moreover, the broader trade and payments architecture is evolving rapidly, adding to many firms' operational complexities and planning uncertainties.

For those who think this is an exaggeration, consider how our new reality has been playing out this year across three domains.

Geopolitical tensions

First, geopolitical tensions are motivating new efforts to exploit and weaponize critical supplies.

The post-Cold War era of frictionless globalization has given way to a scramble for political leverage via existing interdependencies.

State and non-state actors alike have recognized the potential to wield asymmetric power by throttling the physical arteries of global commerce.

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But these strategies have no clear endpoint. No one knows where the current geopolitical fragmentation will lead.

Some hope for what former UK Prime Minister Gordon Brown calls "managed globalization light," others fear an irreparably fractured international order, and some still long for the old days of unfettered globalization and multilateral rule of law.

Yet at this very moment, shipping routes are having to be rewired, and maritime risk premiums remain elevated.

With no grand diplomatic settlement on the horizon, multinational corporations will be forced to shift further from efficient "just-in-time" supply chains to building in more costly "just-in-case" redundancies.

Unpredictable use of tariffs and sanctions

Second, economic policy instruments that once underpinned the functioning of the shared plumbing of a unified global economy are becoming weapons.

The increasingly unpredictable use of tariffs, sanctions, investment controls, and export embargoes is fundamentally altering the calculus of global capital allocation and upending the international financial order as we know it.

As national-security concerns increasingly override economic and commercial efficiency, there are no longer any mutually agreed limits to economic statecraft.

Here, too, the destination or endpoint is unclear, because what were once parameters of the system are now volatile variables.

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Third, markets are being asked to fund massive capital expenditures (capex) in the race to develop and deploy productivity-enhancing technologies.

Tech giants and non-tech incumbents, together, are committing hundreds of billions of dollars to data centers, computing capacity, and AI deployment.

Yet once again, the destination—the point where this unprecedented spending will translate into large, monetizable productivity gains—remains unknown.

Owing to the perceived penalty for falling behind, many corporate boards feel compelled to authorize historic levels of investment without a clear path to earning adequate returns on invested capital.

And because all this capex needs to be financed, the implications for debt markets are far from comforting. Indeed, the cost of capital is already experiencing upward pressure from competing private and public funding claims.

Structural sources of resilience

True, despite the uncertainty around major structural determinants, the global economy and the bond market have so far navigated around the biggest landmines.

But this is largely because a few powerful factors have protected the system.

The first is the dynamism of the US economy, which plays a central role in global growth and innovation, offsetting the structural sluggishness of China and Europe.

The second factor has been the availability of endogenous market liquidity.

Despite the post-2021 monetary-policy tightening, the financial system has generated its own liquidity.

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Deep corporate cash buffers and new financial instruments have kept credit flowing, reinforcing the role of physical inventory buffers—most notably in energy markets, where strategic reserves and flexible refined-product markets have repeatedly absorbed geopolitically driven supply shocks.

But a critical distinction must be made between genuine, structural sources of resilience and the more temporary forms that rely on depletable physical and financial buffers.

Oil inventories have now been drawn down to lows not seen in decades, and abundant endogenous market liquidity may not be relied on—as evidenced by the recent fire sale of overleveraged hedge fund Situational Awareness and the deleveraging of some Korean exchange-traded funds.

Sooner or later, profligate fiscal policies and unbridled corporate capex will collide with rising debt burdens, excessive financial leverage, and higher interest rates.

The reality of bumpy geo-economic transitions

Without clearer endpoints, hopes for a return to the predictable world of the past must give way to the reality of bumpy geo-economic transitions.

Companies, governments, and investors can no longer afford to orient their strategies around single-point forecasts (“baselines”).

Instead, the focus must shift to building even greater resilience, agility, and optionality in the near term.

The months and years ahead will be increasingly characterized by greater economic and financial volatility

These are the strategic assets needed to survive a bumpy, unsettling journey that could veer in any number of directions.

With the buffers that have shielded the global economy depleting, everyone will need to build wider margins of safety.

The system is coasting in part on what will soon be the fumes of borrowed liquidity and drained physical inventories, as well as deficit-funded spending.

As this realization sinks in, the months and years ahead will be increasingly characterized by greater economic and financial volatility, as well as a broader dispersion of outcomes as the gap between winners and losers widens across and within sectors, countries, and financial assets.

We must accept that the absence of widely accepted endpoints constitutes yet another “new normal.”

As destabilizing and disorienting as this structural reality seems, those who embrace it will find that these are the circumstances in which multi-year leads are established, and fortunes are made.

And those who fail to exhibit resilience, agility, and open-mindedness risk the kind of paralysis that undermines economic well-being now and for years to come.

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